



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/19/04	Bill No:	SB 1537
Tax:	Sales and Use	Author:	Soto
Board Position:		Related Bills:	

BILL SUMMARY

This bill would increase the state sales and use tax rate by 0.25 percent.

ANALYSIS

Current Law

Under current law, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state sales and use tax portion and 1.25 percent is the local sales and use tax portion. Due to the passage of Proposition 57, effective July 1, 2004, the state sales and use tax rate will increase to 6.25 percent and the local sales and use tax rate will decrease to 1 percent leaving the statewide rate unchanged at 7.25 percent. Operative July 1, 2004, the components of the state sales and use tax rate of 6.25 percent are as follows:

- 4.75 percent state tax allocated to the state's General Fund (Section 6051 and 6201)
- 0.25 percent state tax allocated to the state's General Fund (Section 6051.3 and 6201.3)
- 0.25 percent state tax allocated to the Fiscal Recovery Fund (Section 6051.5 and 6201.5)
- 0.5 percent state tax allocated to the Local Revenue Fund which is dedicated to local governments for program realignment (Section 6051.2 and 6201.2)
- 0.5 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

In addition to the state portion of sales use tax rate, the following local taxes are imposed by cities and/or counties and are administered by the Board:

- 1 percent Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200).
- Transactions and Use Tax levied at varying rates from 0.125 to 0.5 percent by some cities, counties, and special taxing jurisdictions in various cities and counties within the state and which are distributed to those entities (Part 1.6, commencing with Section 7252).

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Proposed Law

This bill would add Section 6051.5 and 6201.5 to the Revenue and Taxation Code to impose a state sales and use tax at a rate of 0.25 percent. The revenue generated from the proposed sales and use tax rate increase would be transferred to the California Fire Disaster Relief Fund, which this bill would create.

Fixed price engineering construction project contracts, building construction contracts or fixed price leases entered into prior to the effective date of the proposed rate increase would be exempt from the proposed rate increase.

The provisions of the bill would become effective immediately. However, the sales and use tax rate increase would only apply to sales and purchases on and after January 1, 2005, and before January 1, 2007.

Background

California's last state sales and use tax increase occurred in July 1991 with the enactment of AB 2181 (Ch. 85, Stats. 1991). The rate was increased by 1.25 percent in response to the budget shortfall.

Prior to that increase, for a 13-month period beginning December 1, 1989 and ending December 31, 1990, a 0.25 percent state sales and use tax increase was enacted in response to the October 17, 1989 earthquake (commonly referred to as the Loma Prieta earthquake) in the San Francisco Bay Area (SB 33X, Ch. 14X, Stats. 1990, First Extraordinary Session).

Other recent measures related to the state sales and use tax rate include Assembly Bill 7X and Assembly Bill 9e. AB 7X (Ch. 13, Stats. 2003) increases the state sales and use tax rate by 0.5 percent along with a corresponding decrease of 0.5 percent in the local sales and use tax rate as of July 1, 2004. However, these provisions were superseded by the passage of Proposition 57 (AB 9e) in the March 2004 Primary Election, that increase the state sales and use tax rate by 0.25 percent along with a corresponding decrease of 0.25 percent in the local sales and use tax rate as of July 1, 2004.

COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the author. The purpose of this bill is to provide a revenue source for funding a large-scale and proactive approach to the prevention of firestorms and the mitigation of their continuing effects in this state. This bill is in response to the devastating firestorms that occurred in 2003 that burned 750,00 acres, destroyed 4,000 homes, cost \$3.5 billion in insurance losses, and took the lives of 22 individuals.
- 2. Impact of rate change on the Board.** Tax rate changes historically have had a significant effect on the Board. However, this impact is minimized when the rate change takes place on the first day of a calendar quarter and when the Board has sufficient lead time prior to the rate change. Since the proposed tax rate increase would become operative on January 1, 2005, the Board should have sufficient lead time to properly inform the public and prepare revised publications and tax returns.

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3. **This bill should contain a specific appropriation to the Board.** This bill proposes a sales and use tax rate increase that would take effect January 1, 2005, which is in the middle of the state's fiscal year. An adequate appropriation would be required to cover the Board's costs incurred in administering the tax rate change that would not be identified in the Board's 2004-05 budget. Additional costs would be incurred during the 2006-07 fiscal year due to the decrease of the tax rate, and the Board's budget for that fiscal year should be adjusted accordingly to cover such costs.
4. **Partial tax exemptions would apply to the proposed 0.25 percent state sales and use tax.** There are several partial sales and use tax exemptions: farm equipment and machinery, timber harvesting equipment and machinery, diesel fuel used in farming activities and food processing, racehorse breeding stock, property used in teleproduction and post production activities, and the rural investment tax exemption. These partial tax exemption statutes contain provisions that exclude the exemptions from any taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law. These partial tax exemptions also do not apply to taxes levied pursuant to Section 6051.2 and 6201.2 of the Revenue and Taxation Code (also known as the Local Revenue Fund tax), and pursuant to Section 35 of Article XIII of the California Constitution (also known as the Local Public Safety Fund tax). Therefore, the partial tax exemption statutes only apply to the state General Fund portion of the sales and use tax rate. While the proposed 0.25 percent sales and use tax would not be allocated to the General Fund, since this tax is not specifically excluded from the computation of tax for any of the above mentioned partial tax exemptions, it would be included as part of the exempt rate. As of July 1, 2004, the state rate subject to the partial exemptions will be 5.25 percent. If the proposed 0.25 percent increase were to become law, the state rate subject to the partial exemptions would be 5.5 percent.
5. **Proposed 0.25 percent state sales and use tax would not be included in the calculation of the sales tax prepayment rate on motor vehicle fuel, diesel fuel, and aircraft jet fuel.** Suppliers and wholesalers of motor vehicle fuel (gasoline), diesel fuel, and aircraft jet fuel are required to collect a prepayment of a portion of the sales tax when they remove fuel at the terminal rack, enter the fuel into California, or sell the fuels at any point after the removal from the terminal rack. The Board determines the sales tax prepayment rates on these fuels. The rate of prepayment is based on 80 percent of the combined state and local sales tax rate on the average selling price of the fuel as specified in industry publications.

Effective April 1, 2004, the prepayment rates for motor vehicle fuel is \$0.10 per gallon, diesel fuel is \$0.08 per gallon, and aircraft jet fuel is \$0.05 per gallon. These rates are scheduled to remain in effect through March 31, 2005. If the price of these fuels increases or decreases and results in prepayments that consistently exceed or are significantly lower than the fuel retailers' sales tax liability, the Board may adjust the prepayment rates. The Board is required, by November 1 of each year, to establish the prepayment tax rate for these fuels.

Section 6480.1 of the Revenue and Taxation Code requires the Board to establish the sales tax prepayment rates. The specific language in the statutes provides that "the required prepayment shall be established by the board based upon 80 percent of the combined state and local sales tax rate established pursuant to Section 6051,

6051.2, 6051.3, and 7202 of the Revenue and Taxation Code and Section 35 of Article XIII of the California Constitution on the average selling price as determined by the State Energy Resources Conservation and Development Commission in its latest publication of the Quarterly Oil Report.”

Because Section 6480.1 includes the code sections of each state and local tax component, the proposed 0.25 percent would need to be added to Section 6480.1. Without this amendment to Section 6480.1, the prepayment rate would not take into account the additional 0.25 percent rate resulting in lower than normally required prepayment amounts. It is recommended that Section 6480.1 be amended to reference the proposed 0.25 percent rate increase.

- 6. Suggested technical amendment.** This bill would add Sections 6051.5 and 6201.5 to impose an additional 0.25 percent state sales and use tax. However, Sections 6051.5 and 6201.5 are currently used section numbers. Both section numbers were added as part Assembly Bill 7X (Ch. 13, Stats. 2003) and superceded by passage of Proposition 57 (AB 9e). It is recommended that this bill be amended to change the proposed section numbers to 6051.7 and 6201.7.

COST ESTIMATE

A detailed cost estimate is pending. However, changes to the tax rates have historically had a substantial impact on the Board’s administrative costs. Returns would require modification to reflect a new rate. It is anticipated that errors on returns would increase which would result in additional workload in the return processing area. Also, programming costs would be incurred to reflect the new rate, in addition to costs to notify all taxpayers registered with the Board prior to the rate increase.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

This bill would increase the sales and use tax one-fourth of 1 percent. It also would establish a new fund called the California Fire Disaster Relief and Prevention Fund into which the revenue generated by the increase would be deposited. The proposed tax increase would be effective for calendar years 2005 and 2006.

According to the Department of Finance, taxable sales for 2005 are estimated to be \$503.1 billion. Assuming an annual increase of 5 percent, taxable sales for 2006 are estimated to be \$528.3 billion (\$503.1 billion x 0.05).

Revenue Summary

The revenue impact from increasing the sales and use tax one-fourth of 1 percent is as follows:

Year	Estimated Taxable Sales	Revenue Increase
2005	\$503.1 billion	\$1.3 billion
2006	\$528.3 billion	\$1.3 billion

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